January 20, 2015

Mr. Barry Mardock
Deputy Director, Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

RE: Response to Farm Credit Administration's Proposed Regulatory Capital Rule Changes

Dear Mr. Mardock:

Thank you for the opportunity to comment on the Farm Credit Administration's ("FCA") proposed capital rule changes. I am submitting a response to the proposed changes on behalf of Northland Financial Services, LLC ("Northland"). Northland is an AgFirst OFI borrower.

The proposed regulatory capital rule changes are concerning. It appears that the FCA is creating a regulatory environment that would allow for inequitable treatment between an OFI and a Farm Credit Association by a district bank resulting in higher cost of funds, higher capital (equity) investment requirements and lower cash patronage distributions for OFIs. In fact our concerns have merit because AgFirst is currently considering a higher upfront capital investment driven primarily by a change in the risk-weight on the loan balance outstanding to Northland..

FCA is proposes to change the current three tier risk-weight (20%, 50% and 100%) to a two tier risk-weight (20% to 100%). The proposed change results in the elimination of the 50% tier which is the risk-weight assigned to most of the system's OFI borrowers. If this proposal takes effect, OFIs would shift from a 50% to 100% risk-weight. OFIs are asking the FCA to have 20% and 50% as its two tiers rather than 20% and 100%. Alternatively, at a minimum, our recommendation is to keep the existing three tiers and have associated requirements that would allow most OFIs to remain risk-weighted at the 50% tier.

The following supports a 50% versus 100% risk-weight tier:

1. The overall purpose of FCA regulations as it relates to OFIs is to ensure that non-System entities who serve the agricultural sectors in a manner similar to Farm Credit Associations have a realistic window of opportunity to borrow from the System. Risk-weighting requirements should not diminish this opportunity by allowing the potential for increased pricing and/or stock requirements to an OFI simply because it is not a depository institution.
2. From 1923 to 1933, the Federal Intermediate Credit Banks provided funds to U.S. agriculture only through the OFIs. At the time, OFIs were called Agricultural Credit Companies or ACCs. Farm Credit Associations did not exist until 1933 which means that ACCs or OFIs were historically instrumental to the System and deserve recognition and fairness for their historical role.

3. The proposed regulations classify non-depository OFIs as non-regulated institutions. Current regulation 614.4560 (e), requires that any OFI that is not a depository institution consent in writing to examination by the FCA. As a result, FCA has the ability to examine a non-depository OFI. So, this key argument made by the FCA for the 100% risk-weight fails to take into consideration the power that the FCA has for OFI oversight supervision.
4. Another stated reason in the proposed capital regulations for 100% risk-weighting of some OFIs is that the same exposure to a non-depository OFI would receive a 100% risk-weight from a banking organization regulated by a Federal banking regulatory agency. This logic is not valid because entities like OFIs do not borrow from commercial banks because the rates charged by the commercial bank would make them noncompetitive in the marketplace. A commercial bank's lending is retail lending whereas lending to OFIs is wholesale lending.
5. In FCA board member Lee Strom's statement from the May 8, 2014 FCA board meeting, he expressed concern that the proposed new capital treatment could have a detrimental effect on the System's funding of OFIs. Mr. Strom's statement appears to align with our concerns.
6. Regulation 614.4590(a) requires that each Farm Credit Bank apply comparable and objective pricing requirements to both OFIs and Farm Credit System direct lender associations. Further, Regulation 614.4590(b) states that any variation between the overall funding costs that OFIs and direct lender associations are charged by the same funding bank shall result from differences in credit risk and administrative costs to the Farm Credit Bank or agricultural credit bank. For FCA to impose a higher risk-weight would be counter to this regulation because a higher risk-weight may falsely imply a difference in credit risk and administrative costs, even if there aren't any. This would result in higher rates which in turn would make an OFI less competitive than a Farm Credit Association.
7. Most loans at the retail level, whether extended by a Farm Credit Association or an OFI, are risk-weighted 100%. If at the wholesale bank level, the loans provided to an OFI are risk-weighted at 100%, retail loans extended to the borrowers of non-depository OFIs would carry a cumulative risk-weight of 200%, whereas a similar loan to a Farm Credit Association borrower would carry a cumulative risk-weight of only 120%. Again, this difference implies inequitable OFI treatment.
8. The ultimate test of successful lending to an OFI is whether or not the funding bank takes a loss. To manage the risk of loss, the System lenders, have created underwriting and loan conditions for its OFIs that are consistent to those it uses for its Farm Credit Association. If the OFIs have to adhere to the same underwriting, the same loan terms and conditions, and the same pricing and stock investment requirements, then there is no real justification for the large variance in risk-weight.

Again, I appreciate the opportunity to comment on these proposed capital rules and FCA's willingness to consider my feedback.

Sincerely,

Jerry Baker, Vice President of Finance
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